ECONOMIC ASSUMPTIONS

SUMMARY

Economic growth decelerated sharply beginning in the middle of calendar year 2000. The Federal Reserve cut the Federal funds 11 times in 2001, resulting in a total 4¾-percentage-point reduction for the year. In addition, the President last June signed the Economic Growth and Tax Relief Reconciliation Act of 2001 to stimulate the slowing economy. Under normal circumstances, these monetary and fiscal policy responses would have been more than sufficient to reinvigorate the stalled economy. But the terrorist attacks of 11 September temporarily shattered consumer and business confidence, moving the economy from the edge of recession into recession.

There have recently been signs indicating that the recession may be bottoming out. Most forecasters expect economic growth to resume early this year. While private forecasters anticipate a mild recession and a steady recovery, the administration assumes a more gradual recovery, despite its assumption that the policies proposed in the budget – notably, the bipartisan economic security package to insure that the recovery does not falter – will be adopted.

The assumptions employed by the administration's Office of Management and Budget [OMB] project real gross domestic product [GDP] growth rates of 0.7 percent in calendar year 2002, 3.8 percent in 2003, 3.7 percent in 2004, and 3.6 percent in 2005. In contrast, the Congressional Budget Office [CBO] assumes a stronger and more rapid recovery. CBO projects real GDP growth rates of 0.8 percent in 2002, 4.1 percent in 2003, 3.7 percent in 2004, and 3.2 percent in 2005. (See table, next page).

The administration projects inflation rates of 2.0 percent and 1.8 percent in calendar year 2002 and 2003 in terms of chain-weighted GDP price index (favored by the Federal Reserve Chairman Greenspan), and 1.8 percent and 2.2 percent in terms of the Consumer Price Index [CPI]. In comparison, CBO forecasts growth in the GDP price index of 1.4 percent and 2.0 percent in 2002 and 2003 and CPI of 1.8 percent and 2.5 percent. Blue Chip Consensus forecasts GDP price index of 1.6 percent and 1.9 percent and CPI of 1.7 percent and 2.4 percent.

The administration projects unemployment rates of 5.9 percent and 5.5 percent in calendar year 2002 and 2003. The 2002 rate is 0.2 percentage point lower than both CBO and Blue Chip, and the 2003 rate is 0.2 percentage point lower than Blue Chip and 0.4 percentage point lower than CBO. In the medium term, CBO projects 0.3 percentage points higher unemployment rates than

the other two. The administration projects 4.9 percent unemployment rate in the medium term, as it revised its NAIRU (non-accelerating inflation rate of unemployment) from 4.6 percent to 4.9 percent. The private forecasters also project 4.9 percent unemployment rate, while CBO projects 5.2 percent.

Comparison of Economic Assumptions
(calendar years 2002-2007)

	Forecast[a]		Projected			
	2002	**2003**	**2004**	**2005**	**2006**	**2007**
Real GDP (percentage change year over year):						
CBO	0.8	4.1	3.7	3.2	3.2	3.2
OMB	0.7	3.8	3.7	3.6	3.2	3.1
Blue Chip	1.0	3.4	3.4	3.3	3.2	3.1
GDP Price Index (percentage change year over year):						
CBO	1.4	2.0	2.0	2.0	2.0	2.0
OMB	2.0	1.8	1.7	1.8	1.9	1.9
Blue Chip	1.6	1.9	2.1	2.1	2.2	2.2
Consumer Price Index (percentage change year over year):						
CBO	1.8	2.5	2.5	2.5	2.5	2.5
OMB	1.8	2.2	2.3	2.4	2.4	2.4
Blue Chip	1.7	2.4	2.6	2.7	2.7	2.7
Unemployment Rate (percent, annual rate):						
CBO	6.1	5.9	5.4	5.2	5.2	5.2
OMB	5.9	5.5	5.2	5.0	4.9	4.9
Blue Chip	6.1	5.7	4.9	4.9	4.8	4.9
3-month Treasury Bill Rate (percent, annual rate):						
CBO	2.2	4.5	4.9	4.9	4.9	4.9
OMB	2.2	3.5	4.0	4.3	4.3	4.3
Blue Chip	2.1	3.4	4.5	4.7	4.8	4.8
10-year Treasury Note Rate (percent, annual rate):						
CBO	5.0	5.5	5.8	5.8	5.8	5.8
OMB	5.1	5.1	5.1	5.1	5.2	5.2
Blue Chip	5.1	5.6	5.7	5.7	5.7	5.8

[a] OMB's 2002 and 2003 figures are projections.
Source: CBO and OMB.

The administration also projects lower interest rates than CBO and Blue Chip Consensus. Three-month Treasury Bill rates are projected at 2.2 percent in calendar year 2002 and 3.5 percent in 2003, while CBO forecasts 2.2 percent and 4.5 percent. Blue Chip's forecasts are closer to the Administration's in the near term. In the medium term, the administration's projections are 0.4 to 0.6 percentage point lower than the other two. The administration's projection of 10-year Treasury note rates are 5.1 percent for 2002 and 2003, increasing slightly in the out-years. OMB assumes that the Federal Reserve pursues a monetary policy that supports a return to sustainable growth while continuing to keep inflation under control. CBO and Blue Chip project higher long-term interest rates, ranging from 5.5 percent to 5.8 percent.

It should be noted that although OMB is more pessimistic than CBO in some of its economic assumptions, its budget projections are not necessarily more cautious.